

THE TAX FACTOR

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MANDATORY ELECTRONIC FILING

As the Canada Revenue Agency (CRA) moves more of its tax services on-line, certain taxpayers and filers are now required to file their tax information electronically to the CRA. This will reduce costs, and allow for faster and more accurate processing of returns. Beginning in 2010, mandatory electronic filing requirements apply for T2 corporate tax returns and changes have been made which will require more information returns to be filed electronically. Further to these changes, in January the federal government announced new electronic filing requirements for GST/HST registrants. We have provided details of all of these new electronic filing requirements below.

T2 Corporate Tax Returns – Effective for taxation years ending after 2009, corporations with annual gross revenue in excess of \$1 million for a taxation year are required to file their T2 corporate tax returns over the internet. This is done through the CRA's Corporation Internet Filing service or My Business Account service, and CRA approved commercial software must be used to prepare the returns. Note that certain corporations are not required to file electronically and these include insurance corporations, non-resident corporations, corporations reporting in functional currency and corporations that are exempt from tax payable under section 149 of the Income Tax Act (for example, non-profit organizations). As an aside, an administrative concession was made with respect to return filing requirements for certain tax-exempt entities which apply to all taxation years up to and including 2010. For more information on this concession, read our *Tax Factor 2009-03* article titled "[CRA to Continue to Pay Rebates and Refunds to Tax-Exempt Entities](#)".

Although electronic filing will be required for corporate tax returns as noted above, penalties for not filing electronically when required will not apply until 2011. This penalty will gradually increase from \$250 for taxation years that end in 2011, to \$500 for taxation years that end in 2012 and finally to \$1,000 for taxation years that end after 2012.

Information Returns – Beginning in 2010, filers of certain information returns that are submitting more than 50 information slips are required to internet file their returns. Prior to 2010, electronic filing (through the internet or on electronic media) was required where more than 500 information slips were submitted. The new filing requirement applies to most of the common information returns, such as the *T4 Statement of Remuneration Paid*, the *T5 Statement of Investment Income*, and the *T3 Statement of Trust Income Allocations and Designations*. For a complete list of information returns where internet filing is required, go to the CRA's website: <http://www.cra-arc.gc.ca/gncy/bdgt/2009/fqnrmtn-rtrn-eng.html#q9>.

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To internet file information returns, filers can use the CRA's Internet File Transfer (XML) service. For T4 slips, other options for filing include using the CRA's T4 Web Forms (1 to 3 slips) or T4 Desktop Application (1 to 70 slips) or My Business Account.

Mandatory electronic filing relates to the date of filing and not the tax year of the returns being filed. Therefore, if you are filing returns for prior years, these must also be filed over the internet.

There will be a penalty for failing to comply with the mandatory internet filing requirement which will be assessed starting next year on January 1, 2011. The penalty will be calculated based on the number of information returns (i.e. slips) that should have been filed electronically as follows:

NUMBER OF INFORMATION RETURNS (I.E. SLIPS)	PENALTY
51 to 250	\$250
251 to 500	\$500
501 to 2,500	\$1,500
2,501 or more	\$2,500

GST Returns – Effective for reporting periods beginning on or after July 1, 2010, new electronic filing requirements will apply to GST/HST registrants. Currently, only GST/HST registrants meeting certain criteria have the option to file electronically. This will change as all registrants, including those registrants required to file a return with Revenu Québec, will be able to file electronically. Further to this change, the following registrants will be required to file their GST/HST returns electronically as of the effective date noted above:

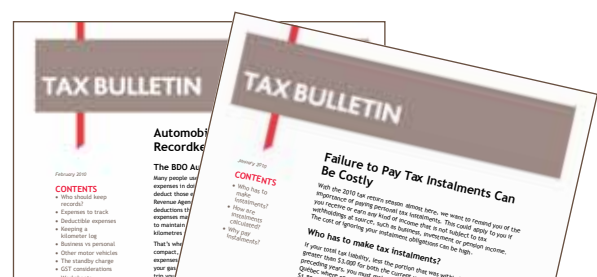
- GST/HST registrants with greater than \$1.5 million in annual taxable supplies (including those supplies of associated persons), with an exception for charities.
- Registrants required to recapture input tax credits (ITCs) for the provincial portion of the HST on certain inputs in Ontario or British Columbia.
- Certain builders that are affected by the transitional housing measures announced by Ontario or British Columbia.

Note that the new electronic filing requirements will apply to GST/HST registrants that file with Revenu Québec and information on the appropriate filing options will be released in the near future.

Those registrants that will be required to electronically file for their first reporting period that ends on or after July 1, 2010, but fail to do so, will be subject to penalties. Further information is expected from the government with respect to these penalties.

The CRA will provide four electronic filing options to GST/HST registrants, however, certain registrants will be required to use a specific option. The four options available are GST/HST NETFILE, GST/HST TELEFILE, EDI (Electronic Data Interchange) and GIFT (GST/HST Internet File Transfer using third party CRA certified accounting software). For details on the specific filing requirements, refer to the chart on the following page.

▶ If you have questions about the new electronic filing requirements for any of the above noted returns, contact your BDO advisor.



RECENT BDO TAX PUBLICATIONS

THE FOLLOWING BDO TAX PUBLICATIONS ARE NOW AVAILABLE:

- New Tax Bulletins: *The Transition to the HST in Ontario* and *The Transition to the HST in British Columbia*
- Updated Tax Bulletins: *Failure to Pay Tax Instalments Can be Costly* and *Automobile Expenses and Recordkeeping*

To obtain a copy of any of the above publications, contact your BDO advisor or visit the BDO Library area of www.bdo.ca.

Summary of GST/HST Registrant Filing Requirements

REGISTRANT CATEGORY	PAPER-FILING	GST/HST NETFILE	GST/HST TELEFILE	EDI	GIFT
Registrants required to recapture certain ITCs - Note (1)	X	✓	X	X	X
Builders affected by certain transitional housing measures – Note (2)	X	✓	X	X	X
Builders that have greater than \$1.5 million in annual taxable supplies, pay or credit a GST/HST new housing rebate amount to the purchaser and claim that amount as a deduction from their GST/HST liability, and <u>do not</u> meet one of the conditions listed in Note (2)	X	✓	✓	X	X
Registrants (excluding charities) with annual taxable supplies exceeding \$1.5 million (including those supplies of associated persons) and that <u>do not</u> fall into any of the categories noted above	X	✓	✓	✓	✓
All other businesses that <u>do not</u> fall into any of the categories noted above	✓	✓	✓	✓	✓

✓ = Acceptable X = Unacceptable EDI = Electronic Data Interchange GIFT = GST/HST Internet File Transfer

Notes:

(1) Registrants required to recapture ITCs for the provincial portion of the HST on certain inputs in Ontario or British Columbia.

(2) Builders that meet one of the following conditions will be required to use GST/HST NETFILE:

- Sell “grandparented” housing where the purchaser is not entitled to claim a GST/HST new housing rebate or new residential rental property rebate,
- Sell housing subject to the HST where the builder purchased that housing on a “grandparented” basis,
- Report the transitional tax adjustment on housing in their net tax calculation for the reporting period, or
- Report provincial transitional new housing rebates claimed for the reporting period.

Note that “grandparented” housing generally refers to the sale or possession of a newly constructed or substantially renovated house that transfers on or after July 1, 2010, but where no HST applies due to the fact that the written purchase and sale agreement was entered into on or before June 18, 2009 (for Ontario) or November 18, 2009 (for British Columbia).



SIGNIFICANT CHANGES TO EMPLOYMENT INSURANCE AND THE CANADA PENSION PLAN

Significant changes are coming to the Employment Insurance (EI) and the Canada Pension Plan (CPP) systems. If you are self-employed and wish to collect EI or you're approaching retirement and plan to collect CPP retirement benefits, this article will be of interest to you.

Changes to Employment Insurance

Chances are if you are self-employed, you have given some thought to the fact that you won't have government assisted income protection for certain times in your life where you can't work and won't have a source of income. These times which can leave you financially strapped include welcoming a new addition to the family, being sick or injured, or caring for a gravely ill family member. Late last year the government passed some long awaited legislation that extends EI to cover special benefits, which are maternity, parental, sickness and compassionate care benefits, to you and others like you, on a voluntary basis.

If you are a self-employed Canadian citizen or permanent resident of Canada and you wish to take advantage of the EI special benefits, you are required to opt into the program at least one year prior to claiming benefits. As well, you will also be responsible for making premium payments for the tax year in which you apply to the program. Unlike the CPP, you will only have to pay the employee portion of the premiums.

Whether or not you opt into the program is something you should consider carefully, as once you're in the program and collect benefits, you cannot opt out. In fact, you will have to contribute on self-employed earnings for as long as you are self-employed. For example, if you are planning on taking one parental leave and you feel that you have financially secured yourself against the other life altering events, then the decision to opt into the program may not be the right one for you. You should give serious thought to your personal circumstances and plans for the future when making this decision as you apparently can't change your mind later once you receive benefits.

Having said that, provided that you have not claimed benefits, you can opt out of the EI program at the end of any tax year. Of course, this would be advisable only if you are certain that you won't have a need for benefits in the future.



You should note that if you enter the program between January 31, 2010 and April 2, 2010, you will be able to make a claim for EI special benefits as early as January 2011. However, if you enter into the program after April 1, 2010, you will have to wait 12 months before you will be able to make a claim for the EI special benefits.

Self-employed residents of Québec will continue to receive maternity and parental benefits through the Québec Parental Insurance plan provided by the Government of Québec. In addition, they will now be eligible to take advantage of sickness and compassionate care benefits offered by the Government of Canada through the EI program (using contribution rates for Québec employees).

There are other specific details and conditions that will apply. If you are self-employed and want to enter the program to become eligible for the EI special benefits, contact your BDO advisor who can assist you in this regard.

Canada Pension Plan Changes

Along with the changes to the EI system, the government has enacted several changes to the CPP. It is important to note at the

outset that these changes will not affect anyone who is currently collecting the CPP retirement, disability or survivor benefits, or anyone who starts to collect their pensions prior to 2011. Note that there are different enactment dates after 2010, and the impact of the changes will depend on when you apply for benefits. To date, representatives from the Régie des Rentes du Québec have not indicated whether the QPP will be harmonized with the recent CPP measures. We have summarized some of the significant changes to the CPP that may affect many of you in years to come.

Removal of Work Cessation Test

Under the current system, in order for you to qualify to collect the CPP retirement pension before you turn age 65 you must either reduce your earnings or stop work for at least two months. After this period, it is possible to work again. Under the new legislation, starting in 2012, this work cessation test will be removed. What this means is that you can start taking your benefit as early as age 60, without any work interruption. If you are planning to take your CPP benefit while continuing to work, either on a full or part-time basis, you will benefit from this change. This may allow you to use your CPP pension to phase into retirement or supplement your earnings while you continue to work.

Increase in the General Low Earnings Drop Out

The CPP retirement pension amount is based on the number of years an individual has worked and contributed to CPP, as well as the salary or wages he or she has earned. In determining the average of earnings over the span of a career, adjustments are made to account for years where an individual's earnings are low or even non-existent. Currently, this provision called the "general low earnings drop out rate" allows for 15% of the years where earnings are low or nil to be dropped from the calculation. This means that if you started your CPP at age 65, then almost seven years of low or zero earnings are removed from the determination of your average earnings.

Under the new legislation, the general low earnings drop out rate is increased to:

- 16% in 2012, allowing a maximum drop out of almost 7.5 years; and
- 17% in 2014, allowing a maximum drop out rate of 8 years.

This is welcome news to individuals that have had several work interruptions.

Pension Coverage for Working Beneficiaries

Under the current system, if you receive a CPP pension and return to work, you will not pay contributions and as a result, you will not continue to build your CPP pension. Under the new system, if you are under age 65 and work while you receive a CPP retirement benefit, you and your employer will be required to make CPP contributions (which will effectively increase your CPP retirement benefit). This rule would be voluntary if you are age 65 and older, but employers of seniors opting to participate in the CPP would be required to also contribute.

Pension Adjustment Changes for Early and Late Take-Up

Under the current system you are permitted to take-up the retirement benefit of the CPP as early as age 60 or alternatively delay the take-up until after you are age 65. To ensure fairness, regardless of the age that the retirement benefit is taken-up, actuarial adjustments are made to the basic amount that would be provided at age 65. These adjustments which are made for pensions taken-up before age 65 and after age 65 will be changed under the new legislation as follows:

- The early pension reduction would be gradually increased to 0.6%, from 0.5%, per month for each month that the pension is taken before age 65. This would be done over a period of five years, starting in 2012.
- The late payment augmentation would be gradually increased to 0.7% from 0.5% per month for each month that the pension is taken after age 65 up to age 70. This would be done over a period of three years starting in 2011.

Consistent with these changes and the determination that 0.5% no longer ensures actuarial fairness, it was determined that regular reporting on the actuarial fair level of the pension adjustment should occur every nine years. Whether you take-up your pension early or late, these new measures will help ensure that amounts that are received are equitable.

▶ Although the impact of these changes will vary based on your personal circumstances, the changes to EI and the CPP are a step in the right direction and demonstrate the government's willingness to improve your economic security whether you're facing retirement or any other life altering events. If you have any questions about how to apply for the new EI special benefits or the new CPP rules, contact your BDO advisor.

THE CRA'S NEW ADMINISTRATIVE POLICY ON EMPLOYER PROVIDED TUITION FEES, SCHOLARSHIPS AND BURSARIES

It has become somewhat of a trend in recent years for employers to offer the family members of their employees free tuition, a scholarship or a bursary. Both employees and employers will likely be interested in the Canada Revenue Agency's (CRA) new administrative policy on these types of payments.

CRA's Previous Administrative Policy

Under the CRA's previous administrative policy, for scholarships and bursaries to be subject to tax in the hands of the student and not the employee, there must have been some limitations on who was eligible to receive it. The selection criteria were often based on scholastic records or other achievements, but in most cases were based on merit. For example, if a limited number of scholarships were awarded by a selection panel to only some eligible persons, then that would be considered a true scholarship. If it was not a "true scholarship", then the CRA's position was that the amount was taxable to the employee as a benefit.

CRA's Revised Administrative Policy

In light of some recent court cases, the CRA has revised its position on these types of payments. Specifically, the CRA now recognizes education assistance as a scholarship even if it is provided to all employees without any limitations around qualification. What this means is that, starting with the 2007 taxation year, these types of payments will not be included in the employee's income. Instead, the fair market value of the amount is to be reported as a scholarship on a T4A slip for the family member. Examples of when the incentive would be considered a scholarship include the following:

- If, as a post-secondary educational institution, an employer provides free tuition to an employee's family member;
- If an employer paid or reimbursed the cost of tuition fees, books and supplies related to post-secondary education for an employee's family member; and
- If an employer operates a post-secondary scholarship or bursary program for the family members of its employees.

It is worth noting that if an employer provides scholarships, bursaries or tuition to an employee's family member who attends either an elementary or secondary school, as opposed to a post-secondary educational institution, the CRA believes that the fair market value



of these benefits will be a taxable benefit to the employee and as such will have to be included in the employee's income.

It should also be pointed out that the revised administrative policy does not apply where it is reasonable to conclude that the amount was received by virtue of a parent's shareholdings as opposed to their employment.

Reporting the Amounts

If you are an employer and have included the fair market value of the tuition fees or a scholarship award for a family member in an employee's income for 2007 and 2008 and fall within the parameters of the new criteria provided by the CRA then you have the option of amending that employee's T4 slip for those years and issuing a T4A slip to the family member. Keep in mind that this change may mean that you overpaid your share of the CPP contributions and EI premiums.

If you have already deducted and remitted these amounts for 2009 you are allowed to correct any remitting errors. Specifically, if you have over-remitted in 2009, attach a note to your T4 summary indicating the reason for the overpayment and whether you want the CRA to transfer this amount to another account or another year, or refund the overpayment to you. If you have already filed your T4 summary, you can ask for an amendment. See *CRA Guide T4001, Employers' Guide - Payroll Deductions and Remittances* available on the CRA's website for more information on this.

THE EVOLVING VIEWS ON DE FACTO CONTROL

There are a number of corporate tax rules that are impacted by whether or not corporations are associated with each other. Certain conditions must be met for corporations to be associated, but in general terms association means that there is common control of two or more corporations (for example, control by the same person or group of non-arm's length persons). For Canadian-controlled private corporations, association is a key concern when it comes to claiming the small business deduction as it means having to share this deduction among associated corporations. Planning may be undertaken to ensure that a corporation is eligible to claim the full small business deduction. However, there are certain rules concerning control that need to be considered when planning within a corporate group.

When determining whether the association rules apply, there are three types of control to consider — de jure control which is legal control of a corporation; de facto control which is factual control; and deemed control which extends the meaning of control to certain situations for purposes of the association rules. The concept of control has been the subject of numerous court cases and, in particular, the views on de facto control appear to be evolving, so it is important to keep current on recent court decisions.

The de facto control test focuses on whether another corporation, person or group of persons has any direct or indirect influence, as opposed to the legal power, that if exercised would result in control in fact of the corporation. Note that de facto control will not apply where the controlling party and the corporation deal at arm's length and influence is derived from a franchise, lease, distribution, supply or management agreement, and the main purpose of the agreement is to govern the relationship between the parties regarding conduct or business.

The Canada Revenue Agency (CRA) has been actively trying to establish de facto control in taxpayer situations in recent years to eliminate tax benefits such as multiple small business deductions in a corporate group. Court decisions have often focused on one of two types of influence when concluding on the existence of de facto control. Certain case decisions have focused on the influence of control at the shareholder level. Based on this type of influence, de facto control may exist if a person or group of persons has the ability to affect the composition of the board of directors or the powers of the board of directors. The other focus has been on operational influence, where de facto control may exist if a person or group of persons has the ability to affect the operations of the corporation, based on day-to-day management decisions and/or economic dependence.



Recent court cases appear to be considering different factors of both shareholder and operational influence. In the *Taber Solids* case, a recent Tax Court of Canada decision, a corporation owned equally by a husband and wife operated a specialized equipment rental and servicing business in the oil and gas industry. A reorganization was undertaken, resulting in two corporations (which we'll call Corporation A and Corporation B). Corporation A, fully owned by the wife, retained the equipment and rented it to Corporation B. The husband owned the majority of Corporation B's shares and this company rented out the equipment to third party oil and gas companies, as well as provided maintenance and repair services.

In this case, the CRA assessed the corporations as being associated requiring them to share the small business deduction. The two corporations were not legally owned by the same person or group of persons, rather the existence of de facto control was at issue. The court considered several factors and found that de facto control existed. The husband had de facto control of Corporation A because he had significant influence over the major operational decision for Corporation B to be Corporation A's only customer. He also had significant influence over the board decisions regarding the acquisition and disposition of Corporation A's equipment. Although the wife made certain board related decisions and took an active role in the business as the sole director of Corporation A, it was enough that the husband had influence over a decision of the board of directors at some point in the year. Further to that, Corporation A had complete economic dependence on Corporation B.

These reasons cover both shareholder influence and operational influence over Corporation A. The Judge noted that prior case decisions suggest that operational control on its own is not sufficient to constitute de facto control, but it is a factor to consider. As well, in this case, de facto control was not a matter of influencing the composition of the board of directors, but rather the influence over the powers of the board together with economic dependence.

▶ As can be seen from this decision, it is important to consider the different factors of influence in a family situation when determining whether de facto control exists.

TAX COURT SETS NEW RESIDENCY RULES FOR TRUSTS

A new Tax Court case has changed the ground rules for determining the residence of a trust. These changes will be of interest where the trustees of a trust are in a different jurisdiction than the people who set up the trust or the trust beneficiaries.

For tax purposes, trusts are deemed to be taxpayers for the purposes of calculating tax, but they are not a legal person or entity in the same way as individuals and corporations. So, there has always been more uncertainty around determining where a trust is resident for tax purposes. This is an important concept, as tax rates vary from province to province and country to country. Historically, a trust's residence has generally been determined based on where the trustee(s) of the trust are resident. For example, if all trustees of a given trust are resident in Alberta, the trust will usually be considered to be resident there even if the settlor of the trust and the trust beneficiaries are resident somewhere else.

A recent Tax Court of Canada case (if it is not reversed on appeal) has added a new test which must be considered when determining where a trust is resident. In particular, the Court has stated that the "mind and management" test used for corporate residency should also apply to trusts. A brief review of the facts of the case will help shed some light on this issue.

In the Garron Family Trust case, the owners of a corporation decided to implement what was referred to as an offshore estate freeze. That is, the Canadian owners retained the value of the corporation that had accrued to date as fixed value preferred shares, and trusts with trustees resident in Barbados subscribed for new growth shares (of holding companies owning the corporation) for nominal consideration. The planning was very similar to many domestic estate freezes except that the trusts were formed outside Canada. On the eventual sale, the plan was that any new growth would escape Canadian taxation, as the trusts were not resident in Canada and the tax treaty with Barbados would exclude the gain on the private company shares from taxation (these shares are "taxable Canadian property" under our tax rules).

When the growth shares held by the trusts were later sold for a substantial gain, tax was withheld on the sale proceeds by the purchaser. When a request was made by the offshore trusts for a refund of the tax, the Canada Revenue Agency (CRA) denied the



request on the basis that the gain on the growth shares was subject to Canadian tax. The CRA presented several arguments for this, one of which was that the trusts were resident in Canada. It should be noted that specific rules have since been implemented that block this planning.

When the Tax Court Judge rendered her decision, she concluded that although trustees resident in Barbados acted on behalf of the trusts, they only did so at a superficial level. That is, they signed the necessary legal documents but they did not possess a working knowledge of the assets they held as trustees and they did not make decisions in the usual manner that the Judge would have expected from bona fide trustees. She believed that the mind and management of the trust remained with the Canadian business owners and they were making the important decisions.

In her case decision, the Judge has essentially set out a two-part test for determining the residence of a trust. First, you need to assess the trustees. Are they acting in a full and prudent manner, or at the other end of the scale, are they simply acting as a custodian for the property? If they are acting in a manner expected of trustees, then their residency will continue to be a key factor in determining the residency of the trust. If the trustees are acting more as a custodian, then the residency of others providing mind and management over the trust property will be a key factor in determining where the trust is resident.

▶ The Garron Family Trust case has been appealed to the Federal Court of Appeal, and that court will presumably decide if it agrees with the new residency tests set out in the Tax Court decision. If the decision is confirmed, then this new mind and management test will be an important issue that must be considered when taxpayers set up a trust in another jurisdiction.

The information in this publication is current as of February 1st, 2010.

This publication has been carefully prepared, but it has been written in general terms and should be seen as broad guidance only. The publication cannot be relied upon to cover specific situations and you should not act, or refrain from acting, upon the information contained therein without obtaining specific professional advice. Please contact BDO Canada LLP to discuss these matters in the context of your particular circumstances. BDO Canada LLP, its partners, employees and agents do not accept or assume any liability or duty of care for any loss arising from any action taken or not taken by anyone in reliance on the information in this publication or for any decision based on it.

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